

General Information Letter: No throwback rule applies to business income from investments in intangible assets which may not be taxed in another state.

April 24, 2001

Dear:

This is in response to your request in our telephone conversation of April 23, 2001, for a letter ruling. The nature of your request requires that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us.

In our conversation, you asked whether the decision of the Illinois Appellate Court in *Home Interiors and Gifts, Inc. v. Dept. of Revenue*, 741 N.E.2d 998 (2000) could cause a corporation domiciled in Illinois to allocate to Illinois all of the taxable interest and dividend income received from a portfolio of investments which does not have an "operational function."

Response

Section 304 of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) provides that a "person other than a resident [who] derives business income from this State and one or more other states" shall apportion that business income to Illinois by formula. "Business income" is defined in Section 1501(a)(1) of the IITA to mean:

income arising from transactions and activity in the regular course of the taxpayer's trade or business, net of the deductions allocable thereto, and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

"Nonbusiness income" is defined in Section 1501(a)(1) simply as "all income other than business income or compensation." Under Section 301(c)(2) of the IITA, a corporation's dividend and interest income that is characterized as nonbusiness income would be allocated to Illinois if the corporation's commercial domicile is in Illinois.

86 Ill. Adm. Code Section 100.3010(a) provides that:

A person's income is business income unless clearly classifiable as nonbusiness income. . . . In general, all transactions and activity which are dependent upon or contribute to the operations of the economic enterprise as a whole will be transactions and activity arising in the regular course of a trade or business.

The decision in *Home Interiors and Gifts* has no relevance to these provisions. In that case, the Circuit Court of Cook County held that interest income earned by the taxpayer on a portfolio of short-term investments was "business income" apportionable to Illinois by formula under Section 304(a) of the Illinois Income Tax Act. The taxpayer did not appeal that holding. Rather, the basis of the taxpayer's appeal and of the Appellate Court's decision was that the United States Constitution

prohibited Illinois from imposing its income tax on that income because the income did not serve an "operational function" related to any business carried on by the taxpayer in Illinois.

The taxpayer and the Department of Revenue stipulated as to the amount of the interest income that could be apportioned if the court ruled in favor of the taxpayer. The Appellate Court held for the taxpayer, and ruled that Illinois could not apportion to Illinois any of the interest income in excess of the stipulated amounts.

The opinion in *Home Interiors and Gifts* does not provide any basis for the State of Illinois to include in net income all of the portfolio income of a corporation domiciled within Illinois. The Appellate Court did not hold that any of the interest income was nonbusiness income, which would be allocable to the commercial domicile of the corporation. The income was therefore business income, which is required to be apportioned under Section 304(a) of the IITA to the extent it could be taxed by Illinois at all.

Moreover, the fact that, under the *Home Interiors and Gifts* rationale, other states might be unable to tax some or all of the portfolio income of a corporation domiciled in Illinois would not affect the amount of income apportionable to Illinois. The concept that income that would normally be apportioned to another state may be apportioned to Illinois if the taxpayer is not subject to tax in the other state is codified in the IITA, but in a manner that excludes its application to portfolio income. Section 304(a)(3)(B)(ii) of the IITA provides that sales of tangible personal property that would normally be sourced to a state other than Illinois may be sourced to Illinois if the seller is not subject to tax in the other state. However, this "throwback" rule expressly applies only to sales of tangible personal property, and cannot apply by analogy to portfolio income. There is nothing in the IITA that would require or allow business income from portfolio investments to be allocated entirely to Illinois merely because the taxpayer is not subject to tax in the state to which the income would otherwise be sourced.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel -- Income Tax